APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 98—September Term, 1964.

(Argued October 28, 1964 Decided December 17, 1964.)

Docket No. 29029

ALLIED CENTRAL STORES, INC., *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

Before: LUMBARD, *Chief Judge*, HAYS and MARSHALL, *Circuit Judges*.

Petition for review of a decision of the Tax Court, Withey, *Judge*, T. C. Memo. 1964-45, CCH Tax Ct. Mem. Dec. 26668(m), denying the deduction of a pre-merger net operating loss carryover from post-merger profits.

Affirmed.

PERCY W. PHILLIPS, Washington, D. C. (Ivins, Phillips & Barker, of counsel), *for Petitioner*.

NORMAN H. WOLFE, Attorney, Department of Justice, Washington, D. C. (Louis F. Oberdorfer, Assistant Attorney General, Lee A. Jackson and Gilbert E. Andrews, Attorneys, Department of Justice, of counsel), *for Respondent*.

HAYS, Circuit Judge:

Petitioner owns and operates a department store in Kansas City, Missouri. In 1953 Heer's, Inc., which owned a department store in Springfield, Missouri, was merged into petitioner and in 1956 two other corporations, L. S. Donaldson Company and The Golden Rule, which together owned five department stores in Minnesota and South Dakota, were merged into petitioner.

Petitioner sought to carry over net operating losses for its fiscal years ending January 31, 1951, 1952 and 1954 as deductions from its taxable income for the fiscal years ending in 1955 and 1957.

Under the authority of *Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382 (1957), the respondent determined that petitioner was not entitled to carry over pre-merger net operating losses as deductions from post-merger income and asserted a deficiency of $155,508.38 for the fiscal year ending January 31, 1957. On petition, the Tax Court held that Section 172 of the Internal Revenue Code of 1954 made the predecessor sections of the 1939 Code, under which *Libson Shops* was decided, applicable to determine whether or not a net operating loss from petitioner's taxable years ending January 31, 1951, 1952 and 1954 could be deducted from 1955 and 1957 income; that the 1939 Code and *Libson Shops* precluded the deduction of carry-overs of pre-merger losses against post-merger income unless the taxpayer could show that the income was produced by substantially the same business unit, i.e., the Kansas City store, that produced the losses; and that petitioner had not made such proof. Therefore, the Tax Court denied the deductions claimed.

We affirm the decision of the Tax Court. We see no distinction between this case and *Libson Shops*. See also our recent decision in *Julius Garfinckel & Co.* v. *Commissioner*, 335 F. 2d 744 (2d Cir. 1964).

Petitioner argues that *Libson Shops* is distinguishable because here there was and could be no change of ownership of any of the merging corporations, all being wholly owned and controlled by a parent corporation during this period, and because there was no change of business enterprise, since the economy identity of the stores as a small group of the parent corporation's nationwide chain of similar stores remained the same before and after the corporate mergers.

But in *Libson Shops* there was likewise no change in ownership. Actually in the present case the ultimate ownership, as reflected in the ownership of the shares of the parent corporation which are traded on the New York Stock Exchange, may well not have been in 1957 in the hands of those who had suffered the losses in 1951, 1952 and 1954.

The parent corporation has chosen to treat the petitioner as a separate entity filing a separate return, rather than as part of a single enterprise filing a consolidated return. As a separate entity the petitioner was not the same "business enterprise" in 1957 that it was prior to the mergers. The regrouping of subsidiaries which have been treated as separate entities, with resultant changes in stated capital, total assets and net worth, has an effect on "continuity."

Petitioner argues that, regardless of the result reached with respect to 1951 and 1952, the Internal Revenue Code of 1954 must be applied to determine the deductibility of net operating losses with respect to loss years ending after December 31, 1953 and therefore to petitioner's fiscal year ending January 31, 1954, and that *Libson Shops* is not applicable under the 1954 Code.

If *Libson Shops* was superseded by the 1954 Code the superseding sections are Sections 381 and 382. However, these sections are applicable only to mergers occurring after June 22, 1954. See Int. Rev. Code of 1954, §§ 393-94. The merger of Heer's into petitioner occurred on October 31, 1953. In order to avoid the application of *Libson Shops* under the 1939 Code, petitioner must argue that a pre-June 22, 1954 merger which occurred in a fiscal year ending after December 31, 1953, is governed by a rule independent of and different from both *Libson Shops* and the special rules of the 1954 Code, i.e., that the congressional purpose in deferring the effect of Sections 381-82 to June 22, 1954, was to abrogate 1939 Code case law for a short time before sub-

stituting the explicit rules of Sections 381-82. But June 22, 1954, was chosen as a convenient date, shortly before which the congressional committees had announced the new rules, from which corporate taxpayers, who planned mergers, etc., would be put on notice of certain tax consequences.[1] We conclude, therefore, that until June 22, 1954, *Libson Shops* remained applicable even to fiscal years ending after December 31, 1953, for the purpose of determining deductibility of net operating losses.

Section 7851(a)(1)(C) of the Internal Revenue Code specifically provides that:

> "The provisions of the Internal Revenue Code of 1939 superseded by provisions of subtitle A of this title [i.e., the income tax provisions] the applicability of which is stated in terms of a specific date (occurring after December 31, 1953) shall be deemed to be included in subtitle A of this title, but shall be applicable only to the period prior to the taking effect of the corresponding provision of subtitle A."

From this section it appears, as the Tax Court held, that those provisions of the 1939 Code which were construed in *Libson Shops* are deemed included in the 1954 Code, but apply only to the period before June 22, 1954, when the specific provisions of Sections 381 and 382 became applicable to mergers.

Affirmed.

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[1] See H. R. Rep. No. 1337, 83d Cong., 2d Sess. A145 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 287-88 (1954); H. R. Rep. No. 2543 (Conference Comm. Report), 83d Cong., 2d Sess. 40-41 (1954); all of which are reprinted in [1954] 3 U. S. Code Cong. Ad. News at 4283-84, 4926-27, 5300.

APPENDIX B

Statutes Involved

Internal Revenue Code of 1939:

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(s) *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * *

"SEC. 122. NET OPERATING LOSS DEDUCTION.

(a) *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) *Amount of Carry-Back and Carry-Over.*—

(1) Net operating loss carry-back.—

* * * * *

(B) Loss for taxable year beginning after 1949.—If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for the preceding taxable year.

(2) Net operating loss carry-over.—

* * * * *

(B) Loss for taxable year beginning after 1949.—If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the five succeeding taxable years,

* * * * *

(c) *Amount of Net operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d)(1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction, or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26(h) and (i)).

Internal Revenue Code of 1954:

"SEC. 172. (a) *Deduction allowed.*—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term 'net operating loss deduction' means the deduction allowed by this subsection.

(b) *Net Operating Loss Carrybacks and Carryovers.*—

(1) *Years to Which Loss May Be Carried.*—A net operating loss for any taxable year ending after December 31, 1953, shall be—

(A) a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss, and

(B) a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

* * * * *

(e) *Law Applicable to Computations.*—In determining the amount of any net operating loss carryback or carryover to any taxable year, the necessary computations involving any other taxable year shall be made under the

law applicable to such other taxable year. The preceding sentence shall apply with respect to all taxable years, whether they begin before, on, or after January 1, 1954.

* * * * *

(g) *Special Transitional Rules.*—

(1) *Losses For Taxable Years Ending Before January 1, 1954.*—For purposes of this section, the determination of the taxable years ending after December 31, 1953, to which a net operating loss for any taxable year ending before January 1, 1954, may be carried shall be made under the Internal Revenue Code of 1939."

"SEC. 381. *Carryovers in Certain Corporate Acquisitions*

(a) *General rule.*—In the case of the acquisition of assets of a corporation by another corporation—

(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334 (b)(2); or

(2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met), or (F) of section 368(a)(1),

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

(b) *Operating rules.*—Except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of section 368(a)(1)—

(1) The taxable year of the distributor or transferor corporation shall end on the date of distribution or transfer.

(2) For purposes of this section, the date of distribution or transfer shall be the day on which the distribution or transfer is completed; except that, under regulations prescribed by the Secretary or his delegate, the date when substantially all of the property has been distributed or transferred may be used if the distributor or transferor corporation ceases all operations, other than liquidating activities, after such date.

(3) The corporation acquiring property in a distribution or transfer described in subsection (a) shall not be entitled to carry back a net operating loss for a taxable year ending after the date of distribution or transfer to a taxable year of the distributor or transferor corporation.

(c) *Items of the distributor or transferor corporation.*—The items referred to in subsection (a) are:

(1) *Net operating loss carryovers.*—The net operating loss carryovers determined under section 172, subject to the following conditions and limitations:

(A) The taxable year of the acquiring corporation to which the net operating loss carryovers of the distributor or transferor corporation are first carried shall be the first taxable year ending after the date of distribution or transfer.

(B) In determining the net operating loss deduction, the portion of such deduction attributable to

the net operating loss carryovers of the distributor or transferor corporation to the first taxable year of the acquiring corporation ending after the date of distribution or transfer shall be limited to an amount which bears the same ratio to the taxable income (determined without regard to a net operating loss deduction) of the acquiring corporation in such taxable year as the number of days in the taxable year after the date of distribution or transfer bears to the total number of days in the taxable year.

(C) For the purpose of determining the amount of the net operating loss carryovers under section 172(b)(2), a net operating loss for a taxable year (hereinafter in this subparagraph referred to as the "loss year") of a distributor or transferor corporation which ends on or before the end of a loss year of the acquiring corporation shall be considered to be a net operating loss for a year prior to such loss year of the acquiring corporation. For the same purpose, the taxable income for a "prior taxable year" (as the term is used in section 172(b)(2)) shall be computed as provided in such section; except that, if the date of distribution or transfer is on a day other than the last day of a taxable year of the acquiring corporation—

(i) such taxable year shall (for the purpose of this subparagraph only) be considered to be 2 taxable years (hereinafter in this subparagraph referred to as the "pre-acquisition part year" and the "post-acquisition part year");

(ii) the pre-acquisition part year shall begin on the same day as such taxable year begins and shall end on the date of distribution or transfer;

(iii) the post-acquisition part year shall begin on the day following the date of distribution or

transfer and shall end on the same day as the end of such taxable year;

(iv) the taxable income for such taxable year (computed with the modifications specified in section 172(b)(2)(A) but without a net operating loss deduction) shall be divided between the pre-acquisition part year and the post-acquisition part year in proportion to the number of days in each;

(v) the net operating loss deduction for the pre-acquisition part year shall be determined as provided in section 172(b)(2)(B), but without regard to a net operating loss year of the distributor or transferor corporation; and

(vi) the net operating loss deduction for the post-acquisition part year shall be determined as provided in section 172(b)(2)(B)."

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"SEC. 382. *Special limitations on net operating loss carryovers*

(a) *Purchase of a corporation and change in its trade or business.*—

(1) *In general.*—If, at the end of a taxable year of a corporation—

(A) any one or more of those persons described in paragraph (2) own a percentage of the total fair market value of the outstanding stock of such corporation which is at least 50 percentage points more than such person or persons owned at—

(i) the beginning of such taxable year, or

(ii) the beginning of the prior taxable year,

(B) the increase in percentage points at the end of such taxable year is attributable to—

(i) a purchase by such person or persons of such stock, the stock of another corporation owning stock in such corporation, or an interest in a partnership or trust owning stock in such corporation, or

(ii) a decrease in the amount of such stock outstanding or the amount of stock outstanding of another corporation owning stock in such corporation, except a decrease resulting from a redemption to pay death taxes to which section 303 applies, and

(C) such corporation has not continued to carry on a trade or business substantially the same as that conducted before any change in the percentage ownership of the fair market value of such stock,

the net operating loss carryovers, if any, from prior taxable years of such corporation to such taxable year and subsequent taxable years shall not be included in the net operating loss deduction for such taxable year and subsequent taxable years.

(2) *Description of person or persons.*—The person or persons referred to in paragraph (1) shall be the 10 persons (or such lesser number as there are persons owning the outstanding stock at the end of such taxable year) who own the greatest percentage of the fair market value of such stock at the end of such taxable year; except that, if any other person owns the same percentage of such stock at such time as is owned by one of the 10 persons, such person shall also be included. If any of the persons are so related that such stock owned by one is attributed to the other under the rules specified in paragraph (3), such persons shall be considered as only one person solely for the purpose of selecting the 10 persons (more or less)

who own the greatest percentage of the fair market value of such outstanding stock.

(3) *Attribution of ownership.*—Section 318 (relating to constructive ownership of stock) shall apply in determining the ownership of stock, except that section 318(a)(2)(C) shall be applied without regard to the 50 percent limitation contained therein.

(4) *Definition of purchase.*—For purposes of this subsection, the term "purchase" means the acquisition of stock, the basis of which is determined solely by reference to its cost to the holder thereof, in a transaction from a person or persons other than the person or persons the ownership of whose stock would be attributed to the holder by application of paragraph (3).

(b) *Change of ownership as the result of a reorganization.*—

(1) *In general.*—If, in the case of a reorganization specified in paragraph (2) of section 381(a), the transferor corporation or the acquiring corporation—

(A) has a net operating loss which is a net operating loss carryover to the first taxable year of the acquiring corporation ending after the date of transfer, and

(B) the stockholders (immediately before the reorganization) of such corporation (hereinafter in this subsection referred to as the "loss corporation"), as the result of owning stock of the loss corporation, own (immediately after the reorganization) less than 20 percent of the fair market value of the outstanding stock of the acquiring corporation,

the total net operating loss carryover from prior taxable years of the loss corporation to the first taxable

year of the acquiring corporation ending after the date of transfer shall be reduced by the percentage determined under paragraph (2).

(2) *Reduction of net operating loss carryover.*—The reduction applicable under paragraph (1) shall be the percentage determined by subtracting from 100 percent—

(A) the percent of the fair market value of the outstanding stock of the acquiring corporation owned (immediately after the reorganization) by the stockholders (immediately before the reorganization) of the loss corporation, as the result of owning stock of the loss corporation, multiplied by

(B) five.

(3) *Exception to limitation in this subsection.*—The limitation in this subsection shall not apply if the transferor corporation and the acquiring corporation are owned substantially by the same persons in the same proportion.

(4) *Net operating loss carryovers to subsequent years.*—In computing the net operating loss carryovers to taxable years subsequent to a taxable year in which there was a limitation applicable to a net operating loss carryover by operation of this subsection, the income in such taxable year, as computed under section 172(b)(2), shall be increased by the amount of the reduction of the total net operating loss carryover determined under paragraph (2).

(5) *Attribution of ownership.*—If the transferor corporation or the acquiring corporation owns (immediately before the reorganization) any of the outstanding stock of the loss corporation, such transferor corporation or acquiring corporation shall, for purposes of this subsection, be treated as owning (immediately after the reorganization) a percentage of

the fair market value of the acquiring corporation's outstanding stock which bears the same ratio to the percentage of the fair market value of the outstanding stock of the loss corporation (immediately before the reorganization) owned by such transferor corporation or acquiring corporation as the fair market value of the total outstanding stock of the loss corporation (immediately before the reorganization) bears to the fair market value of the total outstanding stock of the acquiring corporation (immediately after the reorganization).

(6). *Stock of corporation controlling acquiring corporation.*—If the stockholders of the loss corporation (immediately before the reorganization) own, as a result of the reorganization, stock in a corporation controlling the acquiring corporation, such stock of the controlling corporation shall, for purposes of this subsection, be treated as stock of the acquiring corporation in an amount valued at an equivalent fair market value.

(c) *Definition of stock.*—For purposes of this section, "stock" means all shares except nonvoting stock which is limited and preferred as to dividends."

PART VI—EFFECTIVE DATE OF SUBCHAPTER C

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"SEC. 393. *Effective dates of parts III and IV*

(a) *General rule.*—Except as otherwise provided in this subchapter, parts III and IV shall take effect on June 22, 1954."

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"SEC. 394. *Effective date of part V*

(a) *Section 381.*—Except as otherwise provided in this subchapter, section 381 shall apply to liquidations and re-

organizations, the tax treatment of which is determined under this Code.

(b) *Section 382(a).*—For purposes of applying the special limitation on net operating loss carryovers in section 382(a), the beginning of the taxable years specified in clauses (i) and (ii) of section 382(a)(1)(A) shall be considered to be the beginning of such taxable years or June 22, 1954, whichever occurs later.

(c) *Section 382(b).*—Section 382(b) shall apply to reorganizations, the tax treatment of which is determined under this Code."

"SEC. 395. *Special rules for application of this subchapter*

(a) *Taxable years affected.*—Any provision of this subchapter the applicability of which is stated in terms of a specific date shall apply with respect to taxable years ending after such date. Each provision shall, in the case of a taxable year subject to the Internal Revenue Code of 1939, be deemed to be included in the Internal Revenue Code of 1939, but shall apply only to taxable years ending after such specific date.

(b) *Repeal and continuance of International Revenue Code of 1939.*—To the extent that the provisions of this subchapter supersede the provisions of the Internal Revenue Code of 1939, such provisions of the Internal Revenue Code of 1939 are hereby repealed. The provisions of the Internal Revenue Code of 1939 shall continue to apply with respect to transactions for which rules are provided in this subchapter until such rules take effect."

SUBCHAPTER B—EFFECTIVE DATE AND RELATED PROVISIONS

Sec.
7851. Applicability of revenue laws.

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"SEC. 7851. *Applicablity of revenue laws*

(a) *General rules.*—Except as otherwise provided in any section of this title —

(1) *Subtitle A.*—

(A) Chapters 1, 2, 4, and 6 of this title shall apply only with respect to taxable years beginning after December 31, 1953, and ending after the date of enactment of this title, and with respect to such taxable years, chapters 1 (except sections 143 and 144) and 2, and section 3801, of the Internal Revenue Code of 1939 are hereby repealed.

(B) Chapters 3 and 5 of this title shall apply with respect to payments and transfers occurring after December 31, 1954, and as to such payments and transfers sections 143 and 144 and chapter 7 of the Internal Revenue Code of 1939 are hereby repealed.

(C) Any provision of subtitle A of this title the applicability of which is stated in terms of a specific date (occurring after December 31, 1953), or in terms of taxable years ending after a specific date (occurring after December 31, 1953), shall apply to taxable years ending after such specific date. Each such provision shall, in the case of a taxable year subject to the Internal Revenue Code of 1939, be deemed to be included in the Internal Revenue Code of 1939, but shall be applicable only to taxable years ending after such specific date. The provisions of

the Internal Revenue Code of 1939 superseded by provisions of subtitle A of this title the applicability of which is stated in terms of a specific date (occurring after December 31, 1953) shall be deemed to be included in subtitle A of this title, but shall be applicable only to the period prior to the taking effect of the corresponding provision of subtitle A."

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